

# Bud19#01 - S127B TCA 1997 – Taxation of International Aircrew

REF #:	FIN 00284-18	AUTHOR:	Robert Barnes
TO:	Minister	OWNER:	Robert Barnes
STATUS:	Completed	REVIEWERS:	Joe Cullen, Deirdre Donaghy, John Hogan
PURPOSE:	Finance Bill	DECISION BY:	
DIVISION/OFFICE:	Banking Division		

## Final comment

See copy of Minister's comments attached.

## Action required

Decision as to whether to amend S127B of the Taxes Consolidation Act 1997 in Finance Bill 2018 as regards the tax treatment of international aircrew.

## Executive summary

- Section 127B was introduced in Finance (No. 1) Act 2011 as a measure to avoid double non-taxation of aircrew working on international routes. It ensures that any individual who is employed by an airline that is managed and controlled in the State will be chargeable to Irish Income Tax.
- The matter was brought to your predecessor's attention by Ryanair who sought the change at the time.
- Since 2011, there have been developments at international level including:
  - In 2012, an EU Regulation was introduced to ensure that workers who work in multiple jurisdictions such as aircrew pay social security in what is considered to be their 'home base.'
  - In 2017, the "OECD Model Tax Convention" was updated. The new model proposes that the primary option for the taxation of international aircrew should be that such personnel are taxed only in the individual's country of residence.
- The social security changes have given rise to a situation which a number of Irish-based airlines say is unsustainable commercially. Affected aircrew are paying Income Tax/USC in Ireland but Social Insurance where they are resident, leading to higher marginal tax rates for the staff and competitive pressures for the airlines.

Urgent action to amend s127B is being sought particularly by Ryanair who have made representations on several occasions in recent months.

- This paper presents options as to how best to respond but comes down in favour of no change for the present due mainly to significant Budgetary implications.

## Comments

**Margaret Fitzgerald** - 28/03/2018 18:40

Submitted to the Minister's office by Margaret Fitzgerald on behalf of the Secretary General

## Detailed information

### Background of issue

1. Section 127B (s.127B) of the Taxes Consolidation Act provides that income arising to any individual, whether resident in the State or not, from any employment exercised aboard an aircraft that is operated in international traffic, shall be chargeable to tax in Ireland where the aircraft is operated by an enterprise that has its place of effective management in the State.
2. The provision was introduced at Committee Stage of Finance (No.1) Act 2011 in order to address concerns in relation to the double non-taxation of air crew working for Irish carriers on international routes.
3. A general rule of taxation is that income from Irish employment is taxable in Ireland. Where an employee is tax resident in another country, that country may also claim taxing rights on the income, and double tax agreements are used to allocate the sole or primary taxing rights between the countries in such cases. Such cross-border issues are particularly prevalent in transport industries, e.g. for employees working on board aircraft flying on international routes.
4. In 2010, Ryanair contacted the Department to express concerns in relation to the tax treatment of Ryanair employees, not resident in the State. Ryanair had become aware that certain employees resident outside the State had lodged claims for, and received, repayment of PAYE income tax deductions from their salaries in respect of employment duties exercised outside the State. This allowed for double non-taxation to take place

where the employee was tax resident in a jurisdiction which did not apply tax on income earned outside the state such as, for example, employment income earned on board aircraft on routes in other jurisdictions.

5. Ireland's Double Taxation Agreements (DTAs) in general follow the 'OECD Model Tax Convention' which, prior to 2017, allocated primary taxing rights over income earned by aircrew working on international routes to the country in which the airline was managed and controlled.

6. However, prior to the introduction of Section 127B, a provision did not exist in domestic legislation to exercise these taxation rights given by the treaty Article. Section 18 of the TCA 1997 allowed only for the taxation of income of an individual not resident in the State if the trade, profession or employment is exercised in the State. Airline pilots employed by an Irish based airline but based out of a foreign hub may not be resident in the State and may never exercise their profession in the State and this lead to the potential for reclams of Irish tax withheld at source, as highlighted to the Department in 2010.

7. At the time, Ryanair indicated that c.1,800 of its pilots were based on the Continent, and that if all of the employees were to receive refunds, the costs to the Irish State could run into the tens of millions.

8. A decision was therefore made by your predecessor to introduce the provision now contained in Section 127B which allows a domestic tax charge to be applied to international aircrew who are residents of another State but are employed by an airline headquartered in the Irish State where the relevant DTA specifically allows for this charge. Where the country of residence also seeks to tax the income, the DTA provides tax relief for the tax paid in Ireland when calculating any foreign tax due on the same income.

### **Developments since the introduction of Section 127B**

9. A number of developments have occurred since the introduction of s.127B which are now giving rise to urgent concerns to affected airlines from the perspective of commercial viability.

a) In 2012, EU Regulation (No.465/2012) was introduced to ensure that workers who work in multiple jurisdictions such as aircrew pay social security in what is considered to be their 'home base.' Which is defined as;

*The concept of "home base" for flight crew and cabin crew members is defined as the location nominated by the operator to the crew member from where the crew member normally starts and ends a duty period, or a series of duty periods, and where, under normal conditions, the operator is not responsible for the accommodation of the crew member concerned.[1]*

b) Also in 2017 the OECD updated the 'OECD Model Tax Convention', the template from which Ireland begins negotiations to agree tax treaties with new treaty partner countries. As noted above the previous model treaty allocated primary taxing rights on the income of international aircrew to the country in which the airline was managed and controlled.

c) In 2017, the European Court of Justice upheld a decision from the cour du travail de Mons (Higher Labour Court, Mons, Belgium) that ruled that aircrew must have a contract of employment in the country where they are based or are ordinarily resident. While this has no direct impact on tax treatment of aircrew, it represents an emerging possibility that such personnel could be subject to regulation where they are resident or have their 'home base.'

10. In relation to (b) above, the new OECD model treaty proposes as the primary option for the taxation of international aircrew that such employment income should be taxable only in the individual's country of residence.

11. This change in the OECD Model moves away from associating taxation rights with the "place of effective management of the enterprise is situated," and moves toward recommending that the first taxing right should go to the State where the employee is "resident."

12. This amendment does not impact our existing DTAs as it is a change to the template used to begin negotiations for new DTAs in the first instance, but it is indicative of a broader shift in perspective on the appropriate place of taxation for international aircrew.

## **Current Issues for Irish Based Airlines**

13. After the EU Regulation amendment in 2012, which resulted in individuals being subject to social security in the country where their "home base" is situated, Irish Airlines' aircrew operating in international traffic were made subject to Income Tax and USC in Ireland combined with social security charges that apply in their "home base" country. In many of these countries, social security rates are comparatively higher than our PRSI rates of 4% (employee) and 10.85% (employer), while their income tax contributions may be lower. As a result, many of these employees are paying both the higher (local) social security rate and the higher (Irish) income tax rate, resulting in relatively high marginal rates of tax as compared to aircrew employed by local operators in the countries concerned.

14. Furthermore, while the country of residence is obliged to grant double tax relief for the Irish tax deducted, difficulties can arise in relation to the timing and administration of the relief. Where the country of residence requires local tax to be collected via a PAYE-type system, this can result in the employee having to pay both Irish and local tax up front and then claim double tax relief after the year-end. This can cause a very significant financial burden to the affected employees.

15. Due to the business model of some low-cost airlines, whereby they do not have one central hub where the majority of their staff are based, this split between income tax and social security obligations is causing particular problems. Three companies have expressed their concern directly with Department regarding s.127B over the last two to three years: Cityjet, Norwegian Air and Ryanair. Of these, Ryanair is the most significantly impacted because of its size. In recent months, the company has been particularly active in raising its concerns both directly to you and to the Department at official level. It has written to us several times on the matter and we also met with the company representatives at official level earlier this month. It is seeking urgent action to address what it sees as a huge competitive/commercial issue for it, particularly in relation to the recruitment and retention of pilots.

16. The Department also believes that a fourth Irish-based company, ASL Aviation Holdings, may be impacted by this issue, although on a smaller scale. Aer Lingus are not thought to be heavily impacted by this provision as it is understood that the majority of their aircrews are based and resident in Ireland.

17. All three airlines who have raised the issue have stated that s.127B places Irish Airlines at a significant commercial disadvantage to European competitors who have an effective place of management outside of Ireland.

18. In attempting to challenge s.127B, Cityjet and Norwegian Air have raised a concern that the provision may be contrary to the Freedom of Establishment, however advice from the Attorney General suggests that this may not be a persuasive legal argument.

19. At the end of 2017, Ryanair recognised unions as representatives of their aircrew for the first time in the company's history. The airline has advised that, since this decision, and following the conclusion of the 'Mons' case referred to at paragraph 9 (b) above, there has been increased pressure on the airline from union representatives to provide aircrews with local contracts, and take home pay comparable with competitors. The company is currently in negotiations with local unions in Italy where the matter has particularly come to the fore. The company is urgently seeking a solution that would be viable from its perspective.

20. The international shortage of qualified pilots is also driving cost pressures for airlines. Due to the effects of s.127B, to provide net salaries comparable with locally taxed competitors throughout Europe, Ryanair says it is required to materially increase gross pay levels of its employees.

21. Ryanair have also stated that recent developments in the Italian airline market will further impact on their position in that country. Qatar Airlines have announced a plan to rebrand Meridiana as Air Italy and Ryanair expect that Air Italy will focus on recruiting Ryanair's Italian based pilots by offering them significantly larger net pay packages through favourable local tax structures. In information provided to the Department, Ryanair indicate that it currently has 958 Italian based aircrew who could be impacted by this, accounting for 25% of its total non-Irish based crew. It is currently negotiating with the unions there and cites this a reason behind the need for an urgent decision.

22. Ryanair has provided the Department with data (Attachment II) to illustrate how the implications of s.127B combined with changed EU social insurance regulations are giving rise to high marginal rates of taxation at 65% or above in five locations outside Ireland (Hungary, Italy, Poland, Lithuania and Romania). In the case of Romania, the marginal rate of tax is 83%.

### **Possible developments if s.127B remains unchanged**

23. Ryanair has stated that in the absence of a viable solution - ideally the amendment of s.127B so that it aligns with the OECD model treaty and no longer applies to non-Irish resident aircrew that are subject to income tax in their country of residence - it will be forced to consider alternative operating structures in order to sustain existing operations and the employment of non-Irish resident aircrew. This would include the migration of Ryanair's operations from Ireland. The correspondence from the company indicates that it may well seek to obtain an Air Operators Certificate (AOC) in Italy, and move the management and control of relevant sections of Ryanair's business from the Irish AOC to the Italian AOC. This would remove its employees from the scope of s.127B and from Irish income tax/USC. It is likely that it would also result in the profits of that section of the business becoming subject to Italian Corporation tax rather than Irish Corporation Tax.

24. Cityjet have indicated that they may need to consider a similar relocation of their business to Scandinavia in order to remain viable in the competitive international market.

### **Brief summary of options examined**

**a) DTA Amendment;** In order to address its current negotiating challenges in Italy, Ryanair has proposed an amendment or protocol to the DTA between Ireland and Italy. However, this would not be feasible in a short time frame, and furthermore would address only one local instance of an issue affecting the wider industry. Essentially, this is not a viable option.

**b) Amend s.127B;** Amend the provision to align it with the principles expressed in the new OECD model tax treaty, such that primary taxing rights should be allowed to the country of residence of the aircrew employee. This line of response will involve a significant cost to the Exchequer – see below.

**c) Take no action and make no amendment to legislation for now;** S.127B would remain as it stands. This would leave each enterprise to consider its own business model and to develop its own solution, such as the solution identified by Ryanair to relocate management and control functions to Italy. There is a possibility that this could result in migration of some or all of the affected airlines' management and control out of Ireland with a consequent potential cost in terms of lost income tax/USC and corporation tax. However, decisions on location can involve a variety of factors besides staffing costs and also take time to implement.

### **Options (b) and (c) - Potential Exchequer and Budgetary Implications**

25. Ryanair has stated that it remits well over €200m in taxes to the Irish Exchequer each year and has provided detailed data in support. For the year 2017, this includes €55m in payroll taxes (excl PRSI) for its entire operations and €144m in corporation tax. The company states that of the €55m in payroll taxes, the amount arising from the impact of s.127B is of the order of €35m.

26. Although we do not have similar estimates for other airlines, the quantum of income tax/USC related to s.127B from all affected carriers could be of the order of €40m plus per year. A change in s.127B along the lines sought would mean that such tax would no longer accrue to the Irish Exchequer.

27. At the same time, however, in the absence of a change to s.127B, it cannot be assumed that such tax would continue to accrue as Ryanair, and the other airlines, may migrate parts of their management and operation activities to locations outside Ireland as indicated above. For a variety of reasons, it is difficult to estimate the sums involved as other factors besides costs, e.g regulatory environment, contractual issues and other practicalities are likely to be involved in the carriers' decisions as to the extent of operations that might transfer out of Ireland and the timing of such moves. We know from the data supplied by Ryanair for 2017 that the estimated value of payroll taxes likely to accrue to Ireland from Italian aircrew is almost €7.5m. In terms of the cost implications for the Irish Exchequer of a decision not to amend s.127B, this would mean that, theoretically, the full €40m mentioned in paragraph 26 above could be at risk. In practice, however, a decision now to relocate management and control functions abroad will take time to implement so that the short-term impact on the Exchequer is likely to be at the lower end of the scale. For example, if Ryanair secured an AOC for Italy the cost in income tax/USC foregone could be in the region of the €7.5m already mentioned. As corporation tax is based on profits earned, it is not possible to provide an estimate of any reliability for costs arising on that front.

27. From a budgetary perspective, if a decision was made to amend s.127B on foot of the carriers' concerns, the move would represent a policy change with immediate implications for fiscal space available for other tax measures in Budget 2019 and subsequent years. It is not possible to avoid such an impact. It is estimated therefore that Option (b) above could reduce the fiscal space available for other 2019 Budget measures by an amount in the region of €40 million. There would be no cost impact on the corporation tax side.

28. Having regard to all factors, it is recommended that you give consideration to Option (c) above, do nothing for the present as reassess matters in the course of 2019. The alternative to this is that you decide now to set aside a figure of c.€40m to address a sectoral issue at the expense of the generality of income taxpayers and of retaining full flexibility on budgetary decisions until much closer to the Budget. As indicated above, it is not clear what the airlines will do in practice in response to a decision to leave s.127B unchanged for now but there are good reasons why the airlines may be slow to move large elements of management and operation outside of Ireland. These include higher rates of corporation tax in other countries, the regulatory environment and other factors as mentioned above. In the case of Ryanair, those countries with the largest number of aircrew have corporation tax rates at generally double the Irish or more.

29. In the event that you decide to leave s.127B unaltered for the present, further sustained representations from Ryanair in particular or other measures from the company in support of its case may be expected.

[1] <https://publications.europa.eu/en/publication-detail/-/publication/a8a3c4f2-c66f-11e1-b84a-01aa75ed71a1/language-en>

## Related submissions

There are no related submissions.

## User details

INVOLVED:	Robert Barnes Deirdre Donaghy Joe Cullen Marie O'Leary Deirdre Galvin Heather Cuddy Mairead Ross John Hogan Sub_FIN Sec Gens Office Sub_FIN Ministers Office Niamh Callaghan (PER)	READ RECEIPT:	BTSSP-SC Robert Barnes Marie O'Leary Deirdre Galvin Joe Cullen Deirdre Donaghy John Hogan Margaret Fitzgerald Ed Brophy Helena Quane Rosemary Kearney Mary Young Niamh Callaghan (PER) Mairead Ross
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## Action log

ACTION	DESCRIPTION	USER	DATE
Grant Access	Robert Barnes granted access to Deirdre Donaghy, Joe Cullen	Robert Barnes	26/03/2018 14:44
Grant Access	Robert Barnes granted access to Marie O'Leary, Deirdre Galvin, Heather Cuddy, Mairead Ross	Robert Barnes	26/03/2018 15:47
Sent For Review	Submission sent to Joe Cullen Cullen for review by Robert Barnes	Robert Barnes	26/03/2018 16:41
Reverted to the Author	Submission reverted to Robert Barnes by Joe Cullen Cullen	Joe Cullen	28/03/2018 01:44
Sent For Review	Submission sent to Deirdre Donaghy for review by Robert Barnes	Robert Barnes	28/03/2018 09:10
Ownership Taken	Ownership of submission taken by Robert Barnes	Robert Barnes	28/03/2018 10:20
Attachment removed	Robert Barnes removed attachment Attachment I - The Mons Case.docx	Robert Barnes	28/03/2018 10:31
Attachment removed	Robert Barnes removed attachment Attachment II - Ryanair Information.docx	Robert Barnes	28/03/2018 10:31
Sent For Review	Submission sent to Deirdre Donaghy for review by Robert Barnes	Robert Barnes	28/03/2018 10:34
Sent For Review	Submission sent to Joe Cullen Cullen for review by Deirdre Donaghy	Deirdre Donaghy	28/03/2018 11:02

Sent For Review	Submission sent to John Hogan for review by Joe Cullen Cullen	Joe Cullen	28/03/2018 15:05
Sent to the Secretary General	Submission sent to Secretary General for review by John Hogan	John Hogan	28/03/2018 18:04
Sent to the Minister	Submission sent to Minister for review by Margaret Fitzgerald on behalf of the Secretary General	Margaret Fitzgerald	28/03/2018 18:40
Completed	Submission completed by Rosemary Kearney on behalf of the Minister	Rosemary Kearney	29/03/2018 16:43
Submission sent	Submission sent by email to Antoine MacDonncha.	Joe Cullen	12/11/2018 09:56



## 00284-18: Bud19#01 - S127B TCA 1997 – Taxation of International Aircrew

To: Minister	Author: Robert Barnes
Status: For Review by Minister	Owner: Sub_FIN Ministers Office
Purpose: Finance Bill	Reviewers: Joe Cullen, Deirdre Donaghy, John Hogan
Division/Office: Tax Division	
Decision By:	

### Minister's Comments:

So if I amend s127B the exchequer stands to lose €40 million. On the other hand if I don't amend there is a risk of operation movement out of Ireland with a separate tax & economic loss. Furthermore making a change would involve legislation in between finance bills which I do not want to do. (Could you confirm to me that it requires primary legislation) My current assessment is to vary s127B if this requires legislative change to indicate that we are giving this matter serious consideration but are precluded from action by the Finance Bill timeline.

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Status: For Review by Minister	Owner: Sub_FIN Ministers Office
Purpose: Finance Bill	Reviewers: Joe Cullen, Deirdre Donaghy, John Hogan
Division/Office: Banking Division	
Decision By:	

### Action Required

Decision as to whether to amend S127B of the Taxes Consolidation Act 1997 in Finance Bill 2018 as regards the tax treatment of international aircrew.

### Executive Summary

- Section 127B was introduced in Finance (No. 1) Act 2011 as a measure to avoid double non-taxation of aircrew working on international routes. It ensures that any individual who is employed by an airline that is managed and controlled in the State will be chargeable to Irish Income Tax.
- The matter was brought to your predecessor's attention by Ryanair who sought the change at the time.
- Since 2011, there have been developments at international level including:
  - In 2012, an EU Regulation was introduced to ensure that workers who work in multiple jurisdictions such as aircrew pay social security in what is considered to be their 'home base.'
  - In 2017, the "OECD Model Tax Convention" was updated. The new model proposes that the primary option for the taxation of international aircrew should be that such personnel are taxed only in the individual's country of residence.
- The social security changes have given rise to a situation which a number of Irish-based airlines say is unsustainable commercially. Affected aircrew are paying Income Tax/USC in Ireland but Social Insurance where they are resident, leading to higher marginal tax rates for the staff and competitive pressures for the airlines. Urgent action to amend s127B is being sought particularly by Ryanair who have made representations on several occasions in recent months.
- This paper presents options as to how best to respond but comes down in favour of no change for the present due mainly to significant Budgetary implications.

## Comments

- (28/03/2018 18:40:45) Margaret Fitzgerald: Submitted to the Minister's office by Margaret Fitzgerald on behalf of the Secretary General

## Detailed Information

### Background of issue

1. Section 127B (s.127B) of the Taxes Consolidation Act provides that income arising to any individual, whether resident in the State or not, from any employment exercised aboard an aircraft that is operated in international traffic, shall be chargeable to tax in Ireland where the aircraft is operated by an enterprise that has its place of effective management in the State.
2. The provision was introduced at Committee Stage of Finance (No.1) Act 2011 in order to address concerns in relation to the double non-taxation of air crew working for Irish carriers on international routes.
3. A general rule of taxation is that income from Irish employment is taxable in Ireland. Where an employee is tax resident in another country, that country may also claim taxing rights on the income, and double tax agreements are used to allocate the sole or primary taxing rights between the countries in such cases. Such cross-border issues are particularly prevalent in transport industries, e.g. for employees working on board aircraft flying on international routes.
4. In 2010, Ryanair contacted the Department to express concerns in relation to the tax treatment of Ryanair employees, not resident in the State. Ryanair had become aware that certain employees resident outside the State had lodged claims for, and received, repayment of PAYE income tax deductions from their salaries in respect of employment duties exercised outside the State. This allowed for double non-taxation to take place where the employee was tax resident in a jurisdiction which did not apply tax on income earned outside the state such as, for example, employment income earned on board aircraft on routes in other jurisdictions.

5. Ireland's Double Taxation Agreements (DTAs) in general follow the 'OECD Model Tax Convention' which, prior to 2017, allocated primary taxing rights over income earned by aircrew working on international routes to the country in which the airline was managed and controlled.

6. However, prior to the introduction of Section 127B, a provision did not exist in domestic legislation to exercise these taxation rights given by the treaty Article. Section 18 of the TCA 1997 allowed only for the taxation of income of an individual not resident in the State if the trade, profession or employment is exercised in the State. Airline pilots employed by an Irish based airline but based out of a foreign hub may not be resident in the State and may never exercise their profession in the State and this lead to the potential for reclaims of Irish tax withheld at source, as highlighted to the Department in 2010.

7. At the time, Ryanair indicated that c.1,800 of its pilots were based on the Continent, and that if all of the employees were to receive refunds, the costs to the Irish State could run into the tens of millions.

8. A decision was therefore made by your predecessor to introduce the provision now contained in Section 127B which allows a domestic tax charge to be applied to international aircrew who are residents of another State but are employed by an airline headquartered in the Irish State where the relevant DTA specifically allows for this charge. Where the country of residence also seeks to tax the income, the DTA provides tax relief for the tax paid in Ireland when calculating any foreign tax due on the same income.

### Developments since the introduction of Section 127B

9. A number of developments have occurred since the introduction of s.127B which are now giving rise to urgent concerns to affected airlines from the perspective of commercial viability.

- a) In 2012, EU Regulation (No.465/2012) was introduced to ensure that workers who work in multiple jurisdictions such as aircrew pay social security in what is considered to be their 'home base.' Which is defined as;

*The concept of "home base" for flight crew and cabin crew members is defined as the location nominated by the operator to the crew member from where the crew member normally starts and ends a duty period, or a series of duty periods, and where, under*

normal conditions, the operator is not responsible for the accommodation of the crew member concerned.<sup>11</sup>

b) Also in 2017 the OECD updated the '*OECD Model Tax Convention*', the template from which Ireland begins negotiations to agree tax treaties with new treaty partner countries. As noted above the previous model treaty allocated primary taxing rights on the income of international aircrew to the country in which the airline was managed and controlled.

c) In 2017, the European Court of Justice upheld a decision from the cour du travail de Mons (Higher Labour Court, Mons, Belgium) that ruled that aircrew must have a contract of employment in the country where they are based or are ordinarily resident. While this has no direct impact on tax treatment of aircrew, it represents an emerging possibility that such personnel could be subject to regulation where they are resident or have their 'home base.'

10. In relation to (b) above, the new OECD model treaty proposes as the primary option for the taxation of international aircrew that such employment income should be taxable only in the individual's country of residence.

11. This change in the OECD Model moves away from associating taxation rights with the "place of effective management of the enterprise is situated," and moves toward recommending that the first taxing right should go to the State where the employee is "resident."

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#### Current Issues for Irish Based Airlines

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increased pressure on the airline from union representatives to provide aircrews with local contracts, and take home pay comparable with competitors. The company is currently in negotiations with local unions in Italy where the matter has particularly come to the fore. The company is urgently seeking a solution that would be viable from its perspective.

20. The international shortage of qualified pilots is also driving cost pressures for airlines. Due to the effects of s.127B, to provide net salaries comparable with locally taxed competitors throughout Europe, Ryanair says it is required to materially increase gross pay levels of its employees.

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#### Possible developments if s.127B remains unchanged

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also result in the profits of that section of the business becoming subject to Italian Corporation tax rather than Irish Corporation Tax.

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#### Brief summary of options examined

a) **DTA Amendment;** In order to address its current negotiating challenges in Italy, Ryanair has proposed an amendment or protocol to the DTA between Ireland and Italy. However, this would not be feasible in a short time frame, and furthermore would address only one local instance of an issue affecting the wider industry. Essentially, this is not a viable option.

b) **Amend s.127B;** Amend the provision to align it with the principles expressed in the new OECD model tax treaty, such that primary taxing rights should be allowed to the country of residence of the aircrew employee. This line of response will involve a significant cost to the Exchequer – see below.

c) **Take no action and make no amendment to legislation for now;** S.127B would remain as it stands. This would leave each enterprise to consider its own business model and to develop its own solution, such as the solution identified by Ryanair to relocate management and control functions to Italy. There is a possibility that this could result in migration of some or all of the affected airlines' management and control out of Ireland with a consequent potential cost in terms of lost income tax/USC and corporation tax. However, decisions on location can involve a variety of factors besides staffing costs and also take time to implement.

#### Options (b) and (c) - Potential Exchequer and Budgetary Implications

25. Ryanair has stated that it remits well over €200m in taxes to the Irish Exchequer each year and has provided detailed data in support. For the year 2017, this includes €55m in payroll taxes (excl PRSI) for its entire operations and €144m in corporation tax. The company states that of the €55m in payroll taxes, the amount arising from the impact of s.127B is of the order of €35m.

26. Although we do not have similar estimates for other airlines, the quantum of income tax/USC related to s.127B from all affected carriers could be of the order of €40m plus per year. A change in s.127B along the lines sought would mean that such tax would no longer accrue to the Irish Exchequer.

27. At the same time, however, in the absence of a change to s.127B, it cannot be assumed that such tax would continue to accrue as Ryanair, and the other airlines, may migrate parts of their management and operation activities to locations outside Ireland as indicated above. For a variety of reasons, it is difficult to estimate the sums involved as other factors besides costs, e.g regulatory environment, contractual issues and other practicalities are likely to be involved in the carriers' decisions as to the extent of operations that might transfer out of Ireland and the timing of such moves. We know from the data supplied by Ryanair for 2017 that the estimated value of payroll taxes likely to accrue to Ireland from Italian aircrew is almost €7.5m. In terms of the cost implications for the Irish Exchequer of a decision not to amend s.127B, this would mean that, theoretically, the full €40m mentioned in paragraph 26 above could be at risk. In practice, however, a decision now to relocate management and control functions abroad will take time to implement so that the short-term impact on the Exchequer is likely to be at the lower end of the scale. For example, if Ryanair secured an AOC for Italy the cost in income tax/USC foregone could be in the region of the €7.5m already mentioned. As corporation tax is based on profits earned, it is not possible to provide an estimate of any reliability for costs arising on that front.

27. From a budgetary perspective, if a decision was made to amend s.127B on foot of the carriers' concerns, the move would represent a policy change with immediate implications for fiscal space available for other tax measures in Budget 2019 and subsequent years. It is not possible to avoid such an impact. It is estimated therefore that Option (b) above could reduce the fiscal space available for other 2019 Budget measures by an amount in the region of €40 million. There would be no cost impact on the corporation tax side.

28. Having regard to all factors, it is recommended that you give consideration to Option (c) above, do nothing for the present as reassess matters in the course of 2019. The alternative to this is that you decide now to set aside a figure of c.€40m to address a sectoral issue at the expense of the generality of income taxpayers and of retaining full flexibility on budgetary decisions until much closer to the Budget. As indicated above, it is not clear what the airlines will do in practice in response to a decision to leave s.127B unchanged for now but there are good reasons why the airlines may be slow to move large elements of management and operation outside of Ireland. These include higher rates of corporation tax in other countries, the regulatory environment and other factors as mentioned above. In the case of Ryanair, those countries with the largest number of aircrew have corporation tax rates at generally double the Irish or more.

29. In the event that you decide to leave s.127B unaltered for the present, further sustained representations from Ryanair in particular or other measures from the company in support of its case may be expected.

[1] <https://publications.europa.eu/en/publication-detail/-/publication/a8a3c4f2-c66f-11e1-b84a-01aa75ed71a1/language-en>

## Action Logs

**Created:** 26/03/2018 14:37:03: Submission created by Robert Barnes

**Grant Access:** 26/03/2018 14:44:38: Robert Barnes granted access to Deirdre Donaghy, Joe Cullen

**Reason:** Updated

**Grant Access:** 26/03/2018 15:47:28: Robert Barnes granted access to Marie O'Leary, Deirdre Galvin, Heather Cuddy, Mairead Ross

**Reason:** xx

**Sent For Review:** 26/03/2018 16:41:36: Submission sent to Joe Cullen Cullen for review by Robert Barnes

**Reverted to the Author:** 28/03/2018 01:44:48: Submission reverted to Robert Barnes by Joe Cullen Cullen

**Reason:** Deirdre, Rob, Have a careful read of the attached to catch any factual inaccuracies. If you are happy, I propose that we submit it up the line before 10.30 in the morning. Joe

**Sent For Review:** 28/03/2018 09:10:25: Submission sent to Deirdre Donaghy for review by Robert Barnes

**Ownership Taken:** 28/03/2018 10:20:08: Ownership of submission taken by Robert Barnes

**Reason:** xx

**Attachment removed:** 28/03/2018 10:31:02: Robert Barnes removed attachment Attachment I - The Mons Case.docx

**Attachment removed:** 28/03/2018 10:31:34: Robert Barnes removed attachment Attachment II - Ryanair Information.docx

**Sent For Review:** 28/03/2018 10:34:10: Submission sent to Deirdre Donaghy for review by Robert Barnes

**Sent For Review:** 28/03/2018 11:02:54: Submission sent to Joe Cullen Cullen for review by Deirdre Donaghy

**Sent For Review:** 28/03/2018 15:05:56: Submission sent to John Hogan for review by Joe Cullen Cullen

**Sent to the Secretary General:** 28/03/2018 18:04:35: Submission sent to Secretary General for review by John Hogan

**Sent to the Minister:** 28/03/2018 18:40:46: Submission sent to Minister for review by Margaret Fitzgerald on behalf of the Secretary General

**Reason:** Submitted to the Minister's office by Margaret Fitzgerald on behalf of the Secretary General

## **Attachment I - The 'Mons' Case**

The European Court of Justice upheld a decision from the cour du travail de Mons (Higher Labour Court, Mons, Belgium) that ruled that aircrew must have a contract of employment in the country where they are based or are ordinarily resident.<sup>[2]</sup>

In this case, Ryanair and Crewlink, an agency who specialise in the recruitment and training of cabin crew for airlines, between 2009 and 2011 hired employees from Portugal, Spain and Belgium and set their 'home base' as Charleroi airport in Belgium. All employment contracts for these employees were drafted in English, subject to Irish law and included a jurisdiction clause providing that the Irish courts had jurisdiction.

Six employees brought proceedings before Belgian Courts in 2011 taking the view that Ryanair and Crewlink had to comply with the provisions of Belgian employment law.

The Higher Labour Court, Mons, Belgium asked the ECJ to interpret if it had jurisdiction over these employees under EU Regulation. The ECJ ruled in favour of the employees and determined that cabin crews can derive their rights and applicable law from their home base.

[2] <https://curia.europa.eu/jcms/upload/docs/application/pdf/2017-09/cp170097en.pdf>



**Private and Confidential: Appendix 1 – Illustrative Tax and Social Insurance Calculations**

Exhibit 1	Example of Net Pay Earned by Pilots Earning €150k Under Existing Section 1278	Ireland	Hungary	Italy	Poland	Lithuania	Romania
Gross Salary		€'000 150	€'000 150	€'000 150	€'000 150	€'000 150	€'000 150
Irish Tax (PAYE & USC)		(59)	(59)	(59)	(59)	(59)	(59)
Local Country Employee Social Insurance		(6)	(28)	(11)	(21)	(14)	(53)
Total Irish Tax and Local Social Insurance		(65)	(87)	(70)	(79)	(72)	(111)
Net Pay - Under Section 1278		85	63	80	71	78	39

\*Note - In the instance of Romania, high social local insurance (35%) coupled with the marginal income tax rate in Ireland (48%), results in Romanian resident pilots suffering an effective marginal rate of income tax and social insurance of 83%. This leads to a reduction in net pay of c. 54% when compared to their Irish resident counterparts. Based on the five non-Irish jurisdictions above, on average, pilots suffer a marginal rate of income tax/social insurance of over 65%, and in extreme circumstances such as Romania 83%.

Example of Net Pay Earned by Pilots Earning €150k Under Local Tax Rules	Ireland	Hungary	Italy	Poland	Lithuania	Romania
Gross Salary	€'000 150	€'000 150	€'000 150	€'000 150	€'000 150	€'000 150
Local Income Tax		(23)	(24)	(31)	(23)	(15)
Local Country Employee Social Insurance		(28)	(11)	(21)	(14)	(53)
Total Local Income Tax & Social Insurance		(50)	(35)	(52)	(36)	(68)
Net Pay - Under Local Taxation (i.e. without operation of Section 1278)	100	115	98	114	83	
Net Pay - Under Irish Income Tax & Local Social Insurance (i.e. Under Section 1278)	63	80	71	78	39	

### Exhibit 3

Example of Cost to Irish Airlines to Deliver Same Net Pay to Pilots Compared to Non-Irish Airlines	Ireland	Hungary	Italy	Poland	Lithuania	Romania
Gross Salary	€'000	€'000	€'000	€'000	€'000	€'000
Local Income Tax		259	262	202	234	411
Local Country Employee Social Insurance		(111)	(113)	(77)	(99)	(184)
Total Local Income Tax & Social Insurance		(48)	(35)	(27)	(21)	(144)
		(159)	(147)	(104)	(120)	(328)
<b>Net Pay - Under Section 127B</b>	<b>100</b>	<b>115</b>	<b>98</b>	<b>114</b>	<b>83</b>	
<b>Gross Salary - Under Section 127B</b>	<b>259</b>	<b>262</b>	<b>202</b>	<b>234</b>	<b>411</b>	
Local Country Employer Social Insurance		57	76	14	77	9
<b>Total Employer Cost [i.e. Gross Pay &amp; Employer Social Insurance] - Irish Airline [Under Section 127B]</b>	<b>316</b>	<b>339</b>	<b>216</b>	<b>311</b>	<b>420</b>	
<b>Total Employer Cost [i.e. Gross Pay &amp; Employer Social Insurance] - Non Irish Airline [Local Tax]</b>	<b>183</b>	<b>174</b>	<b>162</b>	<b>199</b>	<b>153</b>	

**As demonstrated above, Irish airlines are at an extreme commercial disadvantage to their non-Irish counterparts where recruiting and remunerating pilots. Due to the application of Section 127B, combined with high employer social insurance rates, the gross salary required to provide an equal net pay offered by non-Irish airlines results in an increased cost as high as 174% of that incurred by a non-Irish Airline. On average, over the five jurisdictions presented, Irish airlines are required to pay an additional €146k per pilot per annum.**